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Local Government Reform

Merger impacts
and analysis



Local Government in NSW

152
local councils

43
metropolitan councils
109
regional councils

 **1,480**
number of councillors
 **44,846**
full time equivalents

FINANCIALS

 **\$10.1b**
expenses from continuing operations

 **\$510m**
financial assistance grants allocated to local councils

 **37%**
of total expenditure is on employee costs

 **111 councils**
reported an operating deficit

 **\$535m**
total state-wide operating deficit reported by councils

ASSETS & INFRASTRUCTURE

 **\$139.0b**
value of total assets

 **\$78.4b**
value of infrastructure

 **\$5.6b**
value of infrastructure backlog

GEOGRAPHY


 **53,534km²**
Central Darling
largest council by area

 **5.7km²**
Hunters Hill
smallest council by area

 **325,185**
Blacktown City Council
largest council by population

 **1,157**
Urana Shire Council
smallest council by population

 **464**
public pools

 **586km**
of levee banks

 **60,791**
development applications determined

 **1,787**
community centres and public halls

 **45,103**
food inspections

 **165,636km**
of roads

Local Government Reform Impacts

112
local councils

25
metropolitan councils
87
regional councils

merger impacts of
\$2.0b
in total financial benefits to
councils over 20 years

FINANCIALS



3 years

payback period when merger benefits will exceed merger costs



\$100m

average annual total financial benefit to local councils from merger



Stronger balance sheets

to fund and deliver local community priorities



\$1.3b

in net financial savings generated by the proposed mergers over a 20 year period

STRONGER LOCAL COUNCILS



Improved scale and capacity

to plan and deliver on future community needs



A stronger voice

to represent local community needs



Effective representation

to meet the future needs of the community



A more regional approach

to support strategic planning and economic development

COMMUNITY BENEFITS



Better infrastructure

invest in enhanced local infrastructure and improved community amenities



Better services

redirect resources to improve frontline services



Less red tape

reduce inconsistencies in council regulations



Rates

reduce local council reliance on rate increases

Introduction

The profile of local communities has changed too, and this will challenge a council's ability to meet the service and infrastructure needs of local residents and businesses. For example, both population growth and an ageing population impact how some metropolitan and regional councils will manage competing priorities and plan for the future.

To deliver these services and maintain local amenities more than 44,800 people are employed in local councils across NSW. Each year these councils spend more than \$10 billion – making NSW councils an important part of the state economy.¹

Many local councils are grappling with the changes taking place in the NSW and Australian economies. These changes include urban development that is placing pressure on local amenities, planning, and road and transport infrastructure.

The profile of local communities has changed too, and this has challenged a council's ability to meet the future service and infrastructure needs of local residents and businesses. For example, both population growth and an ageing population will impact how some metropolitan and regional councils manage competing priorities and plan for the future.

Councils are under increasing pressure to deliver services and infrastructure quickly and efficiently. Further, a lack of resources means that many local councils are unable to plan effectively to meet the changing needs of local people. In 2013-14, 111 out of 152 local councils in NSW reported an operating deficit and the financial outlook for many local councils is poor and not sustainable.²

These financial constraints have created a gap between what services and infrastructure local people want, and what their local council is able to deliver. One key example is the current backlog in maintenance and upkeep of council-owned assets across NSW that requires a \$5.6 billion investment to bring it to a satisfactory condition. Many councils are unable to service and maintain existing community infrastructure – such as local roads, pools and town halls – and are not in a position to invest in the new infrastructure that communities need.

These pressures are often particularly felt by smaller councils that are less able to achieve efficiencies associated with scope and scale. Conversely, a larger council should be able to negotiate better prices for the goods and services they purchase. There is also a growing need for local councils to partner with other councils as well as the NSW Government on major projects. By working collaboratively with other key partners, local councils can play a more strategic role in the development of their region and NSW, while also providing a stronger voice for local communities.

¹ Annual Council Data Returns (2013-14).

² Office of Local Government (2015), Your Council - profile and performance of the NSW local government sector, Sydney.



Proposed reforms and mergers

In response to the wide-ranging challenges facing the sector, the NSW Government has developed a comprehensive reform package. The package aims to create a stronger, higher-capacity and more sustainable local government sector.

To achieve this, council mergers are needed in metropolitan Sydney and regional NSW to help fund better services and infrastructure, improve resilience and reduce reliance on rate increases. The NSW Government has announced a funding package to support merging councils which will result in up to \$665 million being made available to newly created councils.

These proposed mergers will take place as part of a broader package of reforms to modernise the local government sector.

This report assesses the potential impacts of local council mergers – including the impacts on councils' financial performance, as well as potential local community impacts. The key findings of this analysis include:

- the proposed mergers have the potential generate a net financial benefit to local councils of around \$2.0 billion across NSW over the next 20 years;
- an estimated \$1.3 billion in net financial savings will be generated over a 20 year period;
- the estimated costs of the mergers are expected to be absorbed by efficiencies generated by the mergers within three years of implementation;

- the proposed mergers are expected to generate, on average, \$100 million in benefits to local councils every year;
- savings generated by the proposed mergers will be used to improve frontline services, and fund new community amenities and infrastructure – from better local roads and cycleways, to upgraded parks and recreational facilities;
- savings can also be used to repair and replace council-owned assets, many of which are in poor condition; and
- the proposed mergers will result in simplified council regulations through the removal of inconsistencies that currently exist between councils. This will benefit local residents and businesses and streamline the way the community interacts with councils. Reduced layers of regulations will make it easier for people to do business, build homes and access services they need.

This report has been prepared by KPMG on behalf of the NSW Government. Its preparation has relied upon information sourced from annual data returns and long term financial plans of individual councils, and a variety of other publicly available sources. Neither KPMG nor the NSW Government has independently verified such information.



Need for change



Why mergers will strengthen NSW councils

The proposed mergers will support local councils in NSW to respond to the key challenges and drivers of change and strengthen the overall performance of the sector. Analysis and supporting evidence underpinning this assessment of potential merger benefits is provided in the remainder of this report.



Merger benefits

- The savings generated by the proposed mergers are substantial and will lead to improved operating results for affected councils. A local council in better financial health will be better placed to deliver community service and infrastructure priorities.
- Mergers will also reduce reliance on significant rate increases through special rate variations (SRVs) that many councils depend on to fund local community infrastructure projects.
- Merged councils are likely to have a stronger balance sheet with the regional focus required to effectively plan and deliver services and infrastructure. This is particularly important for metropolitan Sydney, where councils will need to adapt and respond to changing community needs and expectations as urban pressures impact on the liveability of our cities.
- Mergers in regional NSW offer an opportunity to build upon the existing connections between regional centres and surrounding communities. Stronger regional centres will be better able to deliver critical services and infrastructure across regional communities.
- Larger councils will have the required strategic capacity to better plan, prioritise and deliver community projects.
- Mergers provide an opportunity to reduce the regulatory burden. Local businesses and residents will benefit from a reduction in the duplication of council regulations, and by the streamlining of inconsistent compliance and regulatory processes that currently exist across many neighbouring councils.
- Larger councils will also be able to reduce unit costs by using increased scale to drive efficiencies. This will enable council resources to be re-directed to frontline services and infrastructure investment.
- The funds freed up by the mergers can be used to buy and build new council services and facilities and to repair and replace existing council assets that are not in a satisfactory condition.
- Mergers may provide regions and local communities with a single, stronger, unified voice to represent local interests and priorities to state and Australian governments.
- Stronger councils are likely to be able to more effectively represent local communities with greater opportunity for strategic regional planning, leading to better amenity and economic development outcomes.



Impact of local government reforms

Merger analysis

A comprehensive analysis was undertaken to evaluate the impacts of the proposed local government reforms. These include quantified and non-quantified impacts, including:

- a financial appraisal of how a merger impacts a council's Long-Term Financial Plans (LTFPs) based on the potential savings and costs generated by the merger;
- an assessment of state-wide merger impacts, including net financial benefits and the overall benefit cost ratio (BCR)³ of the proposed local government reforms;
- other potential impacts and scenarios following council mergers (e.g. regulatory outcomes); and
- scope for increased infrastructure investment.

These impact streams are summarised in Table 1 with an indication of the beneficiaries and bearers of costs.

Table 1. Summary of merger impact streams

Impact stream	Description	Bearer / beneficiary
Financial impacts		
Savings from wages expenditure and redeployment of staff	Mergers will enable councils to eliminate duplication of governance and administration functions and streamline senior management roles. This will lead to savings to wages and salaries expenditure for merged council entities compared to the status quo. Alternatively, reducing the duplication of backoffice functions could allow councils to achieve efficiencies by improving community services through the redeployment of staff to frontline positions.	Local council
Savings from materials and contracts	Mergers will generate scale efficiencies and increased purchasing power resulting in reduced per unit operating costs for some council procurement activities. This will lead to savings in materials and contract expenditure for merged council entities compared to the status quo.	Local council
Savings from councillor fees	Mergers will reduce the total number of elected councillors resulting in reduced councillor fee expenditure compared to the status quo.	Local council

³ The BCR measures the ratio of discounted benefits to discounted costs. It is calculated by dividing the total incremental benefits by the total incremental costs.



Impact stream	Description	Bearer / beneficiary
Financial impacts (continued)		
Costs from redundancies	In some instances, mergers will lead to reduced staffing levels for selected functions, such as governance, administration and senior management. This will require upfront redundancy costs in accordance with industrial laws and regulations. Costs include adhering to a three-year moratorium on forced redundancies for non-executive council employees. Redundancy expenses will therefore be higher for merged council entities compared to the status quo.	Local council
Costs from information and communications technology (ICT)	Mergers will require short-term ICT enhancements enabling new entities to operate with, for example, access to key financial accounts and a single web portal and email domain for the new merged entity.	NSW Government
Costs from merger transition	Mergers will require upfront and one-off transition costs. These include staff retraining, new branding, office relocation expenses, revised business processes and local media and communication initiatives to keep communities informed of developments and changes. These are one-off expenses for merged council entities compared to the status quo.	NSW Government
Broader merger impacts and scenarios		
Reduced regulatory burden	Mergers will lead to a reduction in overlapping and/or inconsistent regulations currently enforced at a local level across council boundaries. Reducing the regulatory burden will result in financial, time and administrative savings for local businesses and residents of merged council entities.	Local communities and businesses
Increased infrastructure investment	Mergers provide an opportunity to re-direct net financial savings generated by the merger toward local infrastructure priorities – either through asset renewal and/or new capital works programs.	Local communities and state-wide
Human capital	Mergers provide an opportunity for councils to reinvent themselves as strong, innovative, dynamic employers that can attract a higher-calibre workforce. This is especially important in regional areas where skills shortages can impact local council operations.	Local council employees

Source: KPMG.

Financial appraisal

The proposed reforms to the local government sector were compared to a 'business-as-usual' base case (status quo) using a discounted cash-flow analysis of local councils' published LTFPs.⁴ The evaluation period for the financial appraisal was 20 years (from 2016 to 2035). All values were expressed in present terms (2015) using a nominal discount rate of 9.5 per cent. It is assumed mergers will be implemented from July 2016.

Table 2 provides the overall results of the financial appraisal of the proposed mergers. Table 3 shows the full merger savings and costs for metropolitan and regional local councils in present value terms. There are potentially significant net benefits associated with the proposed local council mergers. As expected, the aggregate benefits are higher for metropolitan councils compared with councils in regional NSW. This reflects the larger operating budgets of metropolitan councils.

Table 2. Results of the financial appraisal of local government mergers

Measure	Result
Total merger benefits (present value \$m)	\$1,579.3 m
Total merger costs (present value \$m)	\$259.4 m
Net present value (\$m)	\$1,319.9 m
Benefit-cost ratio (BCR)	6.09

Source: KPMG analysis.

Table 3. Merger costs and benefits by category (\$m in present value terms)

Benefit/cost	Metropolitan councils	Regional councils	Comment
Savings category (\$m)			
Savings from wages expenditure and redeployment of staff	\$938.7 m	\$366.3 m	Mergers generally generate savings from a reduction in total wage and salary expenses for both general staff and senior management. Efficiencies are also achieved for those councils that redeploy duplicated backoffice positions to frontline service positions.
Savings from materials and contracts	\$160.1 m	\$69.0 m	Efficiencies generated by larger scale councils and increased purchasing power will lead to reduced costs for council materials and contracts.
Savings from councillor fees	\$37.4 m	\$7.8 m	A reduction in the number of councils (and associated councillors) will lead to reduced councillor fees.
SAVINGS SUBTOTAL	\$1,136.2 m	\$443.1 m	
Costs category (\$m)			
Costs of redundancies	\$48.8 m	\$15.7 m	Redundancies are expected for senior management in the first year and for duplicate backoffice staff following the end of a moratorium on compulsory redundancies in three years.
Costs of ICT	\$54.5 m	\$51.3 m	A modest ICT solution is needed to enable each merged entity to be functional and operational post-merger.
Costs of merger transition	\$56.5 m	\$32.6 m	One-off expenses for transitioning to new merged entities include office relocation, staff training, and other administrative changes.
COSTS SUBTOTAL	\$159.8 m	\$99.7 m	
TOTAL (\$m)	\$976.5 m	\$343.4 m	

Source: KPMG analysis.

⁴ The most recent published LTFPs for most local councils were from the 2013-14 financial year. For some councils, published LTFPs were incomplete and historical / trend data was used to extrapolate financial projections over a ten year period.

Local community impacts of council mergers

Council mergers may generate broader impacts across the community, including:

- improved regulatory outcomes;
- increased infrastructure investment;
- reduced reliance on rate increases;
- scope to improve human capital outcomes for local councils; and
- improved outcomes and services in regional NSW.



Potential for enhanced regulatory outcomes

The NSW Government has made a commitment to reduce the regulatory burden on communities and businesses. There is potential to do this by reducing red tape relating to local councils through both council mergers and an associated increase in the scale and capacity of the sector.

A key regulatory outcome that could be achieved following council mergers is streamlined requirements for businesses operating across local government areas. Research commissioned by the Productivity Commission in 2012 revealed that 28 per cent of small and medium businesses had dealings with multiple local councils and, for these businesses, typically three different local councils were dealt with on regulatory matters.⁵ Key areas where a local council is responsible for enforcing regulations, include:

- building and construction (including planning, zoning and development assessment);
- parking and road transport (access and use);
- food safety (including registration and inspection);
- public health and safety (including public swimming pools); and
- environmental regulation (including coastal management and weed control).

The benefit in establishing councils with larger boundaries and catchment areas is a reduction in potentially inconsistent regulations between councils. For example, currently, businesses that operate in multiple councils (such as tradespersons and shop owners with multiple outlets) are often required to comply with divergent regulatory requirements and obligations. The cost for a business of both monitoring and complying with multiple and varying local council regulations can be reduced through the removal and streamlining of regulatory requirements following a merger of neighbouring councils.

It is acknowledged that in the short term, mergers may create additional complexity and uncertainty for businesses as they respond to changing regulatory requirements. This uncertainty is likely to be addressed early in the transition period.

Scope for increased infrastructure investment

Meeting the current and future infrastructure needs of the community is a priority for the local government sector. The net financial savings generated from council mergers, outlined in the previous section, provide an opportunity to increase investment in local community needs. This can be achieved either through additional investment in asset renewal or new capital works programs.

Modelling indicates that, depending on the extent of financial savings diverted toward new infrastructure expenditure, up to \$100 million could be invested in new capital and community infrastructure every year across NSW. Note that these potential infrastructure investment benefits are based on how the net financial gains generated by a merger could be utilised and should not, therefore, be viewed as additional benefits above and beyond the net financial impacts of councils mergers.

It is important to note that metropolitan council mergers deliver the majority of the net financial savings. The net financial benefits of regional council mergers are significantly smaller in comparison. As a result, the infrastructure backlog reported in regional NSW will likely require additional support.

⁵ Productivity Commission (2012), Performance Benchmarking of Australian Business Regulation: The Role of Local Government as Regulator, Research Report, Canberra.



Potential improved human capital outcomes

The proposed merger of local councils offers opportunities to increase local council capacity to drive improved employment outcomes. These include:

- the ability to employ a wider range of skilled staff;
- greater creativity and innovation;
- access to resources to cope with complex and unexpected change; and
- high quality political and managerial leadership teams.⁶

A key driver of the financial benefits of the reform is the ability for councils to reorganise and prioritise functions, consolidate and streamline back-office positions and reduce overlapping governance and administration roles.⁷ The community may also see benefits from the reorganisation of council activities including redeployment of personnel towards more direct service provision roles. This could improve customer service and response times.

⁶ Sansom Report (2013), *Revitalising Local Government: Final Report of the NSW Independent Local Government Review Panel*, October 2013.

⁷ It is assumed there are no net job losses for regional councils on an FTE basis, with any opportunities to reduce duplication of back office functions leading to FTEs being re-deployed to frontline service delivery.

Box 1. Case study: Improved outcomes and services in regional NSW

Improved outcomes and services in regional NSW

In the early 2000s, five local councils in northern inland NSW merged to form the Tamworth Regional Council. The merger resulted in a council entity with improved strategic capacity and the transformation of the region as a whole in terms of employment, economic contribution, community and social outcomes. Key outcomes and benefits attributable to the merger include:

- service and infrastructure improvements funded by a more robust revenue base;
- investment in regional infrastructure previously not possible;
- increased capacity to take on more large scale projects;
- increased capacity to be an effective political advocate;
- a stronger and more equitable rating system;
- greater capacity to stimulate and promote growth of the local economy;
- significant increase in staff employment opportunities and career development. The merged council has the financial capacity and recruitment capability to attract highly skilled and experienced professionals;
- improved regional decision making and regional strategic infrastructure planning; and
- streamlining regulations and planning policies between councils.

Source: Tamworth Regional Council (2015), *Inquiry Into Local Government in New South Wales*, Submission No. 50, July 2015.

Achieving reform outcomes

Overall, analysis of the economic, financial and community impacts indicates that the proposed local government reforms will address a range of key impediments to the effective functioning of the sector. Specifically, reform strengthens the ability of local councils to meet the current and future service and infrastructure needs of their communities.

The proposed mergers are a change agent rather than an end-goal. They are a catalyst for improved business processes and closer community engagement. Successful mergers will increase capacity to plan and deliver the future service and infrastructure needs of a rapidly changing society. Reform that is underpinned by strong local leadership will pave the way for stronger, greater capacity and more sustainable local government in NSW.



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